

# STATUS OF ECONOMIC REFORMS

in Cooperation Partner Countries in the mid-1990s:  
Opportunities, Constraints, Security Implications

COLLOQUIUM 1995 ✦ COLLOQUE 1995

## ETAT DES REFORMES ECONOMIQUES

dans les pays partenaires de la coopération  
au milieu des années 90:  
chances, contraintes, implications  
en matière de sécurité

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ET BUREAU D'INFORMATION DE LA PRESSE

Reiner Weichhardt  
Editor

Deputy Director  
NATO Economics Directorate



**Status of Economic Reforms in  
Cooperation Partner Countries in the  
mid-1990s: Opportunities, Constraints,  
Security Implications**

Colloquium  
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Brussels



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The articles contained in this volume represent the views of the authors and do not necessarily reflect the official opinion or policy of member governments or NATO.

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## Preface

**Reiner Weichhardt**  
Deputy Director  
NATO Economics Directorate

The 1995 NATO Economics Colloquium - an element of the North Atlantic Cooperation Council (NACC) Work Plan - dealt with economic reforms in Cooperation Partner countries at this mid-decade juncture. Comparative assessments were made with regard to reform experiences and progress in individual countries as well as major reform areas, singling out specific features and common elements.

Chaired by NATO's Director of Economic Affairs, Daniel George, the Colloquium heard presentations by 25 speakers from Allied and Cooperation Partner countries, organised in five panels. A Keynote Speech was delivered by the Minister of Engineering, Military-Industrial Complex and Conversion of Ukraine, Mr. Victor Petrov, and a special lecture on ecological problems of the CIS countries was presented by Dr. Murray Feshbach of Georgetown University in Washington.

The review of reforms in specific countries by Panel I revealed the difficulty of reaching clear, quantitative measures of success. The scope and reliability of statistics are often skewed by unreported developments in the shadow economy and at regional and local levels. Russia, in particular, is characterised by vastly differing regions, in terms of economic resources and political and social conditions. The yardstick used to measure reform in rural areas is totally unsuitable for Moscow and St. Petersburg. In other countries the lack of sound accounting standards, weak financial institutions, and disputes over the pace of reform makes impossible the use of an abstract "reform model" against which progress can be measured.

The key to reform in all countries - the people - was examined by Panel II which covered reform's effect on living standards and social welfare. There was general agreement that essential restrictive policies during the transition period (whether short or long) can impair people's welfare. The necessary balance must be found to provide a social safety net without setting back control of monetary and fiscal policies. This becomes particularly important, and difficult, during election periods when "pork barrel" politics often emerge to appeal to voters.

Privatisation, an element of all reforms, has taken different forms for the various transition economies. Speakers on Panel III noted that so-called voucher (or coupon) privatisation has been successful for some countries while not for others. The key to success or failure has been the degree to which new capital

has flowed into the enterprises and whether the change to private ownership has resulted in competent management. The restructuring of enterprises, whether carried out under state ownership or after privatisation, is also a necessary factor for successful reform.

A major goal of all transition countries is to become an active player in world markets. A number of multilateral and bilateral cooperation schemes and initiatives were discussed by Panel IV speakers. There was agreement that private foreign investments, rather than official aid programmes, will be essential for reform and growth.

The concluding presentation of Panel V noted the linkages between economic reform and stability and the growth of democracy and international security. The transition is complex and many-faceted, and political opportunists will constantly try to utilise temporary setbacks to prove that reforms are unnecessary and detrimental to national welfare. While much attention has been devoted to reduction of military outlays and conversion of unneeded defence industries, this important part of the economies continues to be a heavy burden for many countries. NATO's economic activities under the annual NACC Work Plans will be focused on this essential area of reform.

This book contains all the Colloquium papers. Since only a few up-dates have been made during the editing process, the contributions reflect as accurately as possible the state of information available at the time of the conference. Taking into account the conference focus on crucial reform areas and on the link between economic performance, stability and security, the assessments made also provide a most valuable basis for judging future trends.

Michael Devlin, Editorial Services, Brussels, provided editorial support and coordination in preparing this book. He also produced the useful summaries introducing each paper.

I also wish to express appreciation to Felix Dorough and Margaret Grant of the Economics Directorate staff for further editorial assistance, and to Ulrich Gerza who, as an intern with the Directorate, produced the summary of Colloquium discussions.

**Brussels  
December 1995**

## Welcoming Remarks

**Ambassador SERGIO BALANZINO**  
Deputy Secretary General  
NATO

I am pleased to open this 24th NATO Economics Colloquium and to welcome you to NATO. This Colloquium has not only quite a history since it started in 1971, it has also already become a firm part of our cooperation activities under the North Atlantic Cooperation Council Work Plan.

I am pleased that this part of NATO's activities finds great interest and that we are fortunate to have again such a wide range of speakers and participants from seventeen countries. I can fairly say that economics are key for all of our countries, they are the fundamental basis of our states' stability, our peoples' well-being, and our efforts for security and crisis management.

They all depend on the resources which the economic base of our countries provides. Today, we have a broad understanding of the notion of security. Economics are part of it. Therefore, we invited you to NATO Headquarters to analyse and discuss the related issues together, to promote a common understanding of the underlying principles and challenges.

When the 14th Economics Colloquium was convened in this room in April 1985, the topic was "Adaptability to New Technologies of the USSR and East European Countries". This year, ten years later and after a period of immense political and economic change in these countries, we attempt an appraisal of the status of economic reforms, knowing that the task is still far from being finished. Economic reform is a great challenge. We certainly do not underestimate the situation many countries face in this period of transition and reorientation. Although good progress has been made in most countries in five years, there is great variety in the pace and depth of the reform processes. No single model can guarantee success, but it is clear that all can benefit from sharing knowledge and experiences in fora such as this.

NATO cannot provide economic aid, but it can help gather economic expertise on a remarkably high level, as you can see looking at the impressive list of participants. I encourage you to have a free and broad exchange of ideas. Success will depend on yourselves, your contributions and discussions. One of the main challenges all our countries must cope with is the introduction of new high-tech, capital-intensive industries and the higher unemployment they entail as obsolete plants have to be closed.

Whether it is called "down-sizing" or "right-sizing" - as some Western companies prefer - the result is normally a smaller work force. This is particularly

*Panel I*

**PANEL I\***

**Balance Sheet of Economic Reforms in Cooperation  
Partner Countries**

Chair: Daniel George, Director, NATO Economics Directorate

**Panelists:** László Csaba  
Vladimir Gimpelson  
Vladimir Kuznyetsov  
Gérard Wild

\* The format of panel sessions IV was generally structured as follows: presentations were started with a general overview, then specific Cooperation Partner country studies were discussed. Panels were concluded with an intervention focused on prospects and implications for the West. The latter aspect was expanded and deepened in the final Panel V, which was entirely devoted to this subject.

## ECONOMIC REFORMS IN COOPERATION PARTNER COUNTRIES: A BALANCE SHEET

László Csaba

*It is now clear that there is no quick fix to the problems of Central and Eastern Europe. But Hungarian economist László Csaba shows that the race is definitely to the swift. Countries that have held back on reform are suffering, while those which opted for the 'short sharp shock' method are forging ahead. Other trends are also emerging: the need for more foreign direct investment is paramount; as is the development of investment-friendly banking and taxation systems. Conventional wisdom has been proved wrong: it is not necessarily the big resource-rich countries that are taking the lead. Professor Csaba points out that smaller countries like the Baltic states have created economies flexible enough to stand the sort of external shocks that might break their bigger competitors. His conclusion is that their flexible, 'try-it-and-see' approach is more likely to succeed than any grand scheme.*

*Professor Csaba is a senior Economist, Kopint-Datorg and Professor of International Economics, College of Foreign Trade, Budapest.*

### Overview

Half a decade after the collapse of the Soviet empire, many illusions about systemic change have evaporated. The idea of quick fixes, of fast and irrevocable reforms and unconditional, sustained public support for radical policies looks naive these days. Likewise the zeal of social engineers, claiming to know exactly what is needed for the right brand of capitalism and also how to attain it, invites more irony than respect both inside and outside the region. Reality is different. Transformation means a much deeper set of changes than can be covered by stabilisation and liberalisation. As it has turned out, reforms in the system of *financial mediation, fiscal and social security reforms and industrial restructuring* are no easier tasks in post-socialist countries than these are in mature market economies. Besides time and effort, a lot of "learning by doing" seems to be inevitable to figure out the exact shape of the institutional infrastructure in any country that is able to enhance its competitiveness and more generally, a sustained good economic performance for a long period of time. In other words, stabilisation and liberalisation were necessary to reverse the modernisation crisis in Eastern Europe.

However, without firm institutional backing they fall short of putting the new democracies on the path of a long-term sustainable development which would



enable them to become ripe and lucrative new partners for an enlarging Euro-Atlantic alliance.

Given that the new political forces governing the East since 1993-94 have a sizeable overlap over what we described as old structures, two conclusions may be made.

1. Since they are mostly representatives of the *nomenklatura bourgeoisie*, they might, and often do, have a stake in a blossoming market economy whose profits would accrue to them as the beneficiaries of the spontaneous and organic privatisation of the early transition period.

2. Since their voting base is much wider than this, the inclination to be sensitive to the concerns of old structures, of vested interests, and consequently a keen interest in retaining discretionary decision-making, especially in trade and fiscal policies, can only be expected. This is actually what has been happening in Russia, Hungary, Slovakia and Poland.

This means, that by the mid-1990s the earliest reforming countries are beginning, in analytical terms, to resemble a *typical developing country* of the periphery, where the peculiarities of the post-socialist period gradually give way to the challenges well known to the international financial organisations. This includes lengthy bargains on financial conditions, foot-dragging on fiscal reforms, and the very intensive open clash of competing interest groups over the privatisation of big money-makers, such as banking, public utilities or medical care. The politicisation of privatisation and the resultant frequent suffering of economic common sense must be taken as a normal state of affairs, rather than as a peculiar perversion.

Thus, it is hardly surprising that the early debates on shock therapy versus gradual change have proved by and large irrelevant for policy-making. By now several analyses have proved true: shock therapy is a far cry from what economic liberalism implies in theoretical, functional and policy terms alike (Murrell, 1992; Gligorov, 1995). This makes life difficult, as the radical nature of policy deliberations can no longer serve as a measure of the seriousness, or even of the type of actual reform policy a partner country is conducting. More often than not, a radical vocabulary is a feature of the early stabilisation phase; it has little bearing on what comes when the real hard nut to crack comes around: the changes in structural factors.

### The Hard Core

With the benefit of hindsight we can easily disentangle those components of the policy debates which figured high in contemporary exchanges, but which have little bearing on the type of capitalism that emerges from the ruins of communism. These are mainly the problems related to stabilisation/liberalisation

as well as the proper technologies of privatisation. If these issues look like mere packaging, let us list some of the factors which are the hard core.

### The Role of Domestic versus Foreign Capital

As the mainstream of literature about transformation is distilled from Polish and Russian experience, it is hardly surprising that the major involvement of foreign investors was not seen as realistic in 1989-91. In the longer term, however, no country can afford the luxury of not relying on foreign savings, technologies and networks in its modernising endeavours. Wolfens (1994) correctly describes foreign direct investment as a pacemaker for privatisation in the context of systemic change, if the point of the exercise is improving economic performance measured by dollar intakes, rather than meeting some ideological priority.

However, ideological or general commitment cannot preclude the intense conflict of interest inherent in any privatisation deal.

The Czech and Polish governments are openly concerned about too much of a German influence via FDI, and prefer portfolio investments instead, reflected in the recent strength of the zloty and koruna alike. In Russia, the creation of financial-industrial structures is often portrayed as the real chance for domestic capital (Batchev, S. 1995). Others add to this the avoidance of competitive pressures and the mutual interest of management and the administration to retain public leverage over large firms (Starodubrovskaja, 1995, esp. pp16-17). The two interpretations are not mutually exclusive but mutually reinforcing.

The "national" argument about FDI often overlaps with "social" arguments. The recent opposition of the Meciar government to voucher privatisation, including its open conflicts with foreign owners of investment funds like Nomura, are attacked by supporters of the former Slovak administration on the grounds that *nomenklatura*-direct sales cement existing management. This was indeed the case quite often in Hungary and Poland. On the other hand, firms bought out by their employees or by former owners or shareholders often lack fresh money for restructuring. In the Czech Republic, Hungary and Russia a phenomenon termed by some as second privatisation is already emerging, when those companies able to operate viably in the longer term buy out primary privatisers. The final owners are quite often foreign strategic investors.

These conflicts multiply if big money-spinners are at stake. Barons of the Russian energy sector obviously resent foreign attempts to acquire ownership. Bureaucrats in the administration resist the privatisation of banks - especially of old established large units - for obvious reasons. The more fiscal support is pushed over to the monetary sphere - in the form of cheap credits or preferences - the greater is the need to retain commercial banks in public hands. Since early ideas of creating a large, quickly expanding equity market to replace sluggish

banking proved illusory both in Russia and in the Czech Republic, this remains a lasting source of tension. Employees of the Hungarian electricity company, MVM, have formed a strike committee to defy possible foreign owners.

And Ukraine has fulfilled its ambitious privatisation plan to 3.5 percent in the first quarter of 1995, according to E. Hryhorenko quoted in *The Wall Street Journal Europe*, 30 May 1995, which is an obvious sign of the strength of the status quo. The more the overall business environment resembles that of the home country of investors, the more intensive their involvement will be. Thus the presence of foreign direct investors is the best measure of progress any country has made in its way toward the market.<sup>1</sup>

This concept is related to our seeing transformation as an economic exercise aimed at modernising post-socialist countries. In this context, it is reliance on Western management, up-to-date forms of corporate governance and securing the long-term viability of private firms, rather than the mere change of the title which matters. The latter, in fact, can be irrelevant if e.g. investment funds are owned by public banks, or these funds do not - or are unable to - exert their proprietary rights. The latter seems to be more than an imagined danger in each country having opted for reliance of privatisation funds as a major form of corporate control and privatisation.

### Industry/Bank Links

In the five years since the onset of transformation, no single country has managed to heed the calls for swift privatisation of the banking sector or to create an alternative capital/equity market. As far as the latter is concerned, the equity markets in Prague, Budapest, Moscow, Warsaw and Bratislava are all equally thin, with only a minuscule share of companies actually traded. Furthermore quotations can often be distorted by coincidental or purely extraneous factors such as tax modifications or changes of mood in major countries investing in emerging markets. Against these, the most serious home-made problem is the dominance of treasury bills. Adding all these together implies that *the available capital market is a poor means for evaluating companies or allocating scarce resources at the macroeconomic level.*

Given the universal intertwining of commercial banks and their large clients it has often been suggested that these links be simply cut. Provided this could be done, the question of who should own large public firms and what to do with them remains open. A central agency able to restructure thousands of crisis-ridden companies one by the other used to be the hottest dream of central planners, which, however, never has come true.

As a recent analysis of the Association of Russian Banks (Makarevich, 1995) demonstrated, decentralisation and privatisation alone may only make the problem worse. In Russia banks often run businesses with 15 to 25 times their registered

capital, with no proper risk-assessment, or monitoring of the performance of the client, lacking access to collateral, or even having recourse to publicly guaranteed credit lines. This clearly supports our introductory thesis on the paramount significance of the regulatory and supervisory framework. We would not, however, go as far as some technical analysts and see the way out in imposing proper regulatory discipline alone. It is pretty clear that clients with no track record constitute the majority of new businesses in transition countries. Furthermore, restructuring old clients known to be a bad risk is not the sort of task a commercial bank is prepared for, even in most Western countries. Thus, repeated bank consolidation operations can hardly be avoided, even though the moral hazard inherent in the replication of the bailout is obviously a source of grave risk.

There is no easy solution. The most obvious option would be to sell out some large banks to foreigners to import capital, know-how and management. However, some analysts (Bray and Beck, 1995) see a danger of a strategic turn of Western banking business towards the East, as they see bank reorganisation as too conflict-ridden, too costly and not sufficiently rewarding. For in an overall environment of instability those who lend the least can have the best scores: this has been the strategy of all large Western banks in Hungary.

If, however, investors opt for green-field investment in banking as well, the problem of restructuring old large banks remains the task of public authorities. The opening of a large number of resident offices of all major Western banks in all Eastern capital cities should not obscure the problem which has to do with the size of bad debts and the macroeconomic impact of banks to be restructured.

To avoid the dangers typical of centralised procedures Poland has opted for a decentralised method (Bonin, 1993) where banks and companies could bargain horizontally and figure out solutions. As could be predicted, mating bad banks with bad companies sooner or later invites a central bailout. This has actually happened in 1995 with the consolidation operation enhancing public ownership to 80 percent in banking with far-reaching further indirect ownership in industry and insurance (*Világgazdaság*, 2 June, 1995). To sum up, whatever the technique chosen, there is no escape from a lengthy process of trial and error, where tough management contracts and the sacking of inefficient managers may bring gradual improvement. But the cost of inefficient banking is reflected in unduly high margins and low levels of banking services. The first may be circumvented by more reliance on corporate bonds and direct borrowing from abroad, but the latter will remain a lasting headache for entrepreneurs.

## The Nature and Progress of Fiscal Reforms

Having drawn on the developing country experiences, early transformation policies stressed the stabilising aspects, i.e. subsidy cuts and broadening the tax base. These steps were coupled with implementation of reforms, introducing value-added tax and personal income tax (though often with a delay of several years). It was widely believed that these measures were enough to ensure balanced general government spending and revenues.

This proved to be illusory. It took several years and a lot of disenchantment before knowledgeable analysts (Bruno, 1992; Tanzi, 1993; Kornai, 1992) drew attention to the paradoxes peculiar to transition that render the attainment of balanced budgets next to impossible. In a nutshell, reforms creating a free-market institutional infrastructure, like tax reforms and also privatisation, often imply revenue shortfalls, whereas spending cuts could become politically embarrassing, especially amidst a deep recession. It took some time before international agencies realised that their focusing on the short term budgetary indicators was often misleading, on occasion counter-productive.

Once proper and consolidated accounting according to the GFS standards is introduced - a task yet to be mastered in most partner countries - several weaknesses of public finance come to light. First, the private sector tends to pay significantly fewer taxes per unit of income than the public sector. This applies *a fortiori* to small business which is the dynamically expanding segment of transforming economies. Meanwhile, ailing large companies do not pay taxes as they run at a loss. The entitlement system, from pensions to health care, is very broad while the revenue base is shrinking. Abolishing the social safety net would have been suicidal, while maintenance of the extensive social benefit system cannot be financed any longer. This is in many ways akin to the problems faced by ageing Western welfare states. This issue has only recently been raised in full in Poland, Hungary and the Czech Republic, and is yet to be tackled by other partner countries.

On top of this, *fiscal practices* leave a lot to be desired. The reliance on a large number of special funds not integrated in the budget is a source of confusion and obfuscation. State-owned firms can afford the luxury of not paying public dues. Municipalities can typically spend without raising their own revenues. Large state-owned firms are regularly bailed out. In most partner countries *tax accounting standards* allow for commercial banks to show fat profits where standard EU procedures would show heavy losses.

As there is a great deal of interest in covering up these imperfections, it is not surprising to see *high inflation* as the basic means to make both ends meet. In this way the state inflates away the revenues squeezed out of the public coffers by various powerful vested interests. This is a painless solution in the short run. However, it leads to persistently high levels of inflation; undermines the credibility of the national currency; renders corporate accounting irrelevant;

and makes savings in local currency unprofitable. These are, unfortunately, typical traits of a pre-reform Latin economy, where weak government, conceptual confusion and intensive in-fighting by vested interests translate into high levels of inflation and low levels of investment, especially in the private sector.

There is nothing unique or insoluble to this set of problems: what Williamson (1994) describes as the Washington consensus on development economics offers a fairly straightforward answer to them. But this answer is given only in technical terms: the task of building up a reform constituency and of managing sound economic policies over a single election cycle remains the job of local élites.

The relevance of this problem has been shown by several developments in the East. Bulgaria in 1991-93 and Serbia in 1994 attempted a very harsh and also successful stabilisation policy. However, as institutional reform stagnated, these policies were bound to soften up. On the other hand, the experience of Poland, Lithuania, Hungary and Slovakia are indicative of the importance of systemic reforms, which can and indeed did ensure the required stability of reformist policies across changing governmental teams.

## External Economic Relations

One of the most fashionable subjects discussed in the early transformation period was the feasibility of reorienting commercial relations from East to the West. These controversies have produced a voluminous literature on transitory arrangements and régimes, from barter to hard currency trade. In reality, these were not implemented anywhere. Much to the surprise of most external analysts, it was not only the Visegrád countries who succeeded in reorientation, but also Bulgaria and Romania. Similarly, Slovenia and Croatia also mastered the "impossible" task of reorienting their respective economies.

As far as successor-states of the Soviet Union are concerned, what has happened was more or less the *opposite to what could have been expected on the grounds of trade theory*. In the latter, larger and resource rich countries should have had an edge over tiny and resource-dependent economies. This would have put countries like Kazakhstan, Turkmenistan and Ukraine on the top, with the Baltic states suffering the most. The vision proved to be the mirror image of reality. The Baltic countries, having instituted radical stabilisation and transformation policies, have created flexible economies able to adjust to major external shocks.

Intimately related to these issues is the role of *international financial institutions* in shaping the priorities and techniques of systemic change. Contrary to frequent allegations (e.g. Glaziev, 1995), detailed analytical and country studies (Schönfeld, ed, 1995) do not lend support to the claim that the International Monetary Fund (IMF) is dictating terms or fashioning policies or institutions. On the contrary, in the majority of cases domestic policy factors are dominant beyond doubt.

Suffice to recall the notorious inefficiency of multi-year structural adjustment programmes of the IMF, or the regular non-compliance with quantitative targets of standby agreements (most recently by Bulgaria).

In reality, a significant amount of time and effort has been spent on circumventing the spirit of economic common sense embodied in the IMF proposals in order to enable politicians to play to their respective domestic audiences. In fact, it was always the outcome of power plays - or extreme cases of need - which sometimes allowed some of the IMF medicines to be taken by some countries.

It is relatively easy to prove the marginal role of international financial institutions in the transformation. Being an international bureaucracy, bound by the norms of even-handedness, the IMF cannot but suggest by and large the Washington consensus to its clients. If all of them were taking the advice, the outcome should also be quite similar. Thus the glaring diversity of experiences, from Albania to Turkmenia, from Estonia to Belarus, from Slovenia to Ukraine may suffice to highlight the *paramount significance of domestic factors* over any external influence.

### Medium-Term Outlook

Regular regional overviews published by international organisations and research institutes allow us to form three groups of the transition economies. These seem to follow a different pattern for longer periods of time. Classification can, of course, never be definitive or final; however for analytical purposes the trial may be worth the run.

### The Visegrád Countries (Czech and Slovak Republics, Hungary and Poland) Slovenia and the Baltic Countries

These nations have crossed the threshold of institutional change. They have overcome stabilisation and entered the phase of sustained economic growth. They can keep the rate of inflation at what is internationally termed as moderate. The dominant type of enterprise behaviour as well as the major source of wealth creation, is outside the public sector. National currencies have stabilised, and payments and accumulation are conducted in these monetary units. Political changes, including changes of government, occur in an organised and peaceful fashion via internationally supervised free elections. Accession to the EU seems to be almost certain, though its timing remains contingent upon EU reforms, as shown above. The point of no return in both political and economic terms has been crossed, and the quality of the market order is already close to that of the EU (cf below).

### Southeast European Countries and Russia

Though hyper-inflation has mostly been arrested, sluggish institutional change may destroy macroeconomic successes. The role of the state as well as that of the ruling coalition seems to be cemented for a longer period of time. Activist policies in forming economic structures are advocated and are often inevitable due to weakness of the markets. Inflation remains high - 60 percent in good years of Romania and Bulgaria - and convertible currencies continue to play a significant role both in inter-firm contracts and as a store of value. Economic growth has yet to stabilise or materialise. The role of FDI is marginal and the autonomous private sector survives only in symbiosis with the public sector.

Partly for this reason, partly due to the feebleness of a competitive environment and the survival of old habits, actually or nominally privatised firms frequently do not behave very differently from public firms: they lobby for the favours of the authorities, try to avoid layoffs and postpone structural changes (Ash and Hare, 1994). This makes a great difference versus what can be observed in the first group, where public firms are also pushed to adjust in a competitive manner. Bankruptcy and the threat of closure are non-existent in this group, whereas - to varying degrees - they do clear the market in group no. 1. Fiscal reforms, too, lag behind the former group and the openness of the trade régime is also much less obvious.

### Ukraine, Belarus, Transcaucasian and Central Asian Republics

Here both socio-political and economic changes away from the inherited Soviet pattern proved to be the smallest. Rampant inflation and dominant public ownership, and the collapse of output alongside formally maintained full employment result in officially unconvertible currencies. The rigid economic pattern, i.e. the inability to master major structural changes save divestment of unviable defence and related industries, means they are almost totally dependent on Russian oil supply and the Russian market. There is a long way before the conditions of sustainable development and even of financial stabilisation can be created. The danger of economic depressions becoming a destabilising factor, and the lure of using nationalism to alleviate tensions is sizeable. Despite the three major post-Soviet states' renouncing the nuclear arsenal in the Budapest summit of the OSCE in December 1994, the potential insecurity of these countries remains a lasting problem.

The three groups of countries differ in terms of *market maturity*, in terms of the economic and political role of the state - as opposed to self-regulation and the role of civic society, and therefore the role of FDI and the role of the EU will also differ. As a consequence, EU and NATO partnership policies will play an enduringly different role for these groups for many years to come.

Coming back to economics, if there is anything general to be said about a wide variety of economic reforms it is the following. Our bird's-eye view supported more theoretical findings (Fehl and von Delhaes, 1995) about the *crucial role of competition in shaping the qualities of an economic order*. Put the other way around, contrary to early convictions, the outcome of transformation is not contingent upon the progress made in privatisation. It is more dependent upon progress made towards establishing competitive or at least contestable markets for as many factors of production as possible and as enduringly as possible.

When privatisation coexists with retaining monopoly positions or in symbiosis with public-sector firms it may not necessarily enhance efficiency.

This highlights three conclusions:

- *Privatisation* was bound to have different outcomes in different countries with different cultural backgrounds and different market maturities.
- There is going to be a continued *regulatory competition* not only globally but also among the transforming countries.
- As a consequence *no optimal strategy* can be theoretically postulated (cf Csaba, 1995, pp. 121-145) that could serve as a base to assess national strategies with cross-country validity. While at the theoretical level, no such comparisons are possible, the world commodity and capital markets, but also the labour market continuously do the abstractly impossible job of comparing, assessing and evaluating what is inherently non measurable. Thus transforming countries *will continue to fare quite differently* on the troubled waters of the world economy.

This also means that generalised schemes, grand designs and grand bargains are not very helpful in orientating decision makers. Nor are they going to acquire this quality in the future. For the more general and more abstract a theory or scheme is, the more universal its coverage may be.

Meanwhile its value for helping solve *practical* matters, like Eastern expansion of NATO or ways of cooperation with the Euro-Atlantic structures, is bound to decrease in proportion. In other words: there is no escape from the challenge of elaborating a *differentiated strategy* when drawing the security implications of diverse economic reform stories in the East.

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Footnote

1. First the Kiel Institute of World Economics (Heitger, et al, 1992), and later the European Bank (EBRD, 1994) attempted to create a set of comprehensive indicators for market maturity. However helpful these may be, as the editor of the latter report, Bartholdy (1995) concedes, any such set of indicators is loaded with subjective elements, whereas *ex post* inflows are facts beyond dispute.

## ECONOMIC REFORMS IN RUSSIA

Vladimir Gimpelson

*Vladimir Gimpelson asks whether Russia will survive as a united country, or fall apart like the former USSR. The collapse of central planning has revealed the vast differences between Russia's regions. The gap between regional priorities and federal interest may provide just the opening that separatists can exploit. But Dr. Gimpelson concludes that the hard-line proponents of regional autonomy are too weak, and too closely identified with the old order. In the regions, support for economic reform outweighs the support for separatism. His verdict is that separatists have too much to lose from the break-up of Russia - and they know it.*

*Dr. Gimpelson is Head of Department, Institute of World Economy and International Relations, Russian Academy of Sciences, Moscow.*

### Russian Reforms in Regional Dimension

A balance-sheet of reforms has many aspects: political, financial, social, moral, etc. I would like to focus my short presentation on the regional dimension of the Russian transition. The Chechen war highlighted once again that successes and failures in reforming Russia are, to a considerable extent, regionally dependent. A threat of separatism proved to be rather efficient in squeezing special privileges from the centre. The weak Federal Government is forced to be very sensitive to local elites which have strong control over their localities and population. The forthcoming Parliamentary elections can strengthen this influence even more.

One of the key questions often raised is whether Russia will survive as a united country or fall to pieces as happened with the Soviet Union. I think this is a very important issue with obvious implications not only for the Russian reforms but for international security as well. I want to pinpoint right now that I do not believe in the most pessimistic scenario; nevertheless I consider policy on the relationship between the centre and the regions as very important for future development.

### Structural Aspects of Regional Policy

Vast inter-regional economic differentials in Soviet Russia used to be mitigated by the strong centre that redistributed resources and incomes between regions. The collapse of the party-state system weakened the centre and destroyed this